Supreme Court, U.S.
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IN THE

Supreme Court of the United States

KAWASAKI MOTORS CORP., U.S.A.,

Petitioner,

v.

BOB SCHULTZ MOTORS, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (the "FAA"), the District Court ordered arbitration of the parties' dispute, rejecting challenges to the enforceability of the parties' arbitration agreement. After ruling on the merits of the dispute, the Arbitrator concluded that the District Court had erred in enforcing the arbitration agreement. Based upon that conclusion, the Arbitrator refused to enforce the remaining executory term of the arbitration agreement, which provided that the losing party pays the winning party's arbitration expenses and costs. The District Court denied a request to vacate or modify the award under FAA Sections 10 or 11, and the Eighth Circuit affirmed. The questions presented are:

1. Whether the enforceability of the terms of an arbitration agreement is an issue of arbitrability for the courts to decide under the FAA.

2. Whether a court's pre-arbitration ruling on arbitrability under Section 4 of the FAA constrains the scope of an arbitrator's powers within the meaning of Section 10(a)(4) or the scope of the matters submitted to the arbitrator within the meaning of Section 11(b) for purposes of post-arbitration judicial review.

PETITIONER KAWASAKI MOTORS CORP., U.S.A'S STATEMENT OF PARTIES AND CORPORATE DISCLOSURE STATEMENT

The parties are listed in the caption of this case. Petitioner Kawasaki Motors Corp , U.S.A. is a wholly-owned subsidiary of Kawasaki Heavy Industries, Ltd., which is a publicly-held Japanese corporation in which no shareholder owns more than 10% of the shares.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Kawasaki Motors Corp., U.S.A. ("Kawasaki") hereby respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case, which was entered on July 1, 2003.

OPINIONS BELOW

The District Court's Order (The Honorable Charles A. Shaw), dated March 26, 2002, denying Kawasaki's motion to vacate or modify the arbitrator's decision, is unpublished. It is reprinted in the Appendix at App. A-51 to A-64. The Court of Appeals' opinion (App. A-1 to A-12) is reported at 334 F.3d 721 (8th Cir. 2003).

JURISDICTIONAL STATEMENT

The Court of Appeals entered its judgment on July 1, 2003. It denied Kawasaki's timely petition for rehearing *en banc* on August 13, 2003. Kawasaki invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, are reproduced at App. A-65 through A-69.

STATEMENT OF THE CASE

A. Summary

Bob Schultz Motors, Inc. ("Schultz Motors"), a Kawasaki franchisee, sued Kawasaki under numerous legal theories and sought a declaratory judgment that an arbitration agreement between the parties (the "Arbitration Agreement") was unenforceable. The District Court rejected Schultz Motors' contention, ruling that the Arbitration Agreement was enforceable, and directed the parties to arbitration. Neither the District Court's orders nor the pleading pending at the time of arbitration submitted the enforceability of the Arbitration Agreement's terms to arbitration.

After ruling in favor of Kawasaki on the merits of the dispute, the Arbitrator proceeded to consider Kawasaki's request for attorney's fees pursuant to a fee shifting provision in the Arbitration Agreement. The Arbitrator – disagreeing with the district court's prior conclusion – concluded that the Arbitration Agreement was unenforceable. Since the arbitration had already occurred, however, the Arbitrator simply refused to enforce the only remaining executory term of the Arbitration Agreement, which provided that the losing party pays the winning party's expenses and fees.

Kawasaki then challenged the arbitrator's ruling. Both the District Court and the Court of Appeals ruled that such enforceability issues were for the Arbitrator, rejecting Kawasaki's challenge that the Arbitrator exceeded his authority or ruled upon a matter not submitted to him.

B. The Arbitration Agreement

The Arbitration Agreement between Schultz Motors and Kawasaki is contained in the parties' Dealer Sales and Service Agreement. It reads as follows:

> 32. Dispute Resolution
>
> All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR, relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claims or disputes, except those expressly excluded above. Judgment upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against the DISTRIBUTOR, or in any court which has jurisdiction over DEALER, if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing

party all costs and expenses of the arbitration, including without limitation, attorney's fees.

C. Schultz Motors sued Kawasaki

On February 23, 1993, Schultz Motors filed a five count state court petition against Kawasaki, seeking relief for Kawasaki's alleged wrongful failure to permit Schultz Motors to purchase another Kawasaki dealership. Schultz Motors alleged breach of contract, tortious interference with contractual relationship, breach of third party beneficiary contract, and violations of the Missouri Motor Vehicle Franchise Practices Act. Schultz Motors' petition also included a separate count for declaratory relief, challenging the enforceability of the Arbitration Agreement.

Kawasaki removed the action to the United States District Court for the Eastern District of Missouri and filed a motion to dismiss each count of Schultz Motors' petition. Among other things, Kawasaki asserted that the Arbitration Agreement was enforceable and sought to have any claims that were not dismissed referred to arbitration.

D. The District Court held that the Arbitration Agreement was enforceable and referred the dispute to arbitration.

On March 30, 1994, the District Court ruled on Kawasaki's Motion to Dismiss, dismissing Schultz Motors' third-party beneficiary and tortious interference claims for failure to state a claim. App. A-24 to A-25. The District Court also ruled for Kawasaki on Schultz Motors' declaratory judgment claim, holding that the Arbitration Agreement was enforceable. The District Court directed the parties to arbitrate Schultz Motors' remaining two claims (breach of contract and a statutory count), finding that those claims were within the scope of the Arbitration Agreement. App. A-24 to A-25.

In the course of ruling on the declaratory judgment count, the district court addressed each of Schultz Motors' claims that the Arbitration Agreement was unenforceable. The district court concluded that Schultz Motors had not established that the arbitration agreement 1) was unconscionable or inherently unfair, 2) constituted a contract of adhesion, 3) lacked mutuality of obligation, or 4) violated the Missouri Motor Vehicle Franchise Practices Act.[1] App. A-18 to A-21. The District Court therefore concluded that the Arbitration Agreement was enforceable and compelled arbitration. App. A-24 to A-25.

E. Schultz Motors filed a Demand for Arbitration

After the District Court's ruling, Schultz Motors submitted a Demand for Arbitration, dated September 27, 1994, on the American Arbitration Association's standard commercial arbitration form. In its demand, Schultz Motors conceded that the District Court had not submitted to arbitration most of the enforceability arguments raised in its petition. "[T]he District Court issued an order . . . determining, *inter alia*, that . . . only one of the of the numerous arguments presented in Count V of the Petition in support of Bob Schultz' claim that the applicable Arbitration clause be declared unenforceable should be decided in arbitration, namely . . . duress."[2]

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[1] Schultz Motors also had alleged duress as a ground for avoiding the Arbitration Agreement. The District Court found that this allegation went to the formation of the entire Dealer Sales and Service Agreement and therefore, under *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1966), should be decided by the arbitrator. This issue dropped out of the litigation, however, when Schultz Motors abandoned the issue in correspondence with the arbitrator before the arbitration hearing.

[2] As to the duress argument, see footnote 1, above.

Nevertheless, Schultz Motors requested that the arbitrator rule on its enforceability arguments because it thought that such a request might be necessary to preserve its disagreement with the District Court for appeal. "Bob Schultz submits these latter grounds [concerning enforceability] for consideration by the arbitrators [sic] herein, despite the District Court's prior determinations as to them, because Bob Schultz believes that the District Court determinations were erroneous and that submission of them to the arbitrators [sic] may be necessary to preserve said grounds for appeal." The arbitration did not proceed upon this Demand for Arbitration, however, as Schultz Motors filed two more statements of its claim.

F. Schultz Motors filed an Amended Demand for Arbitration, which the District Court limited in scope

Schultz Motors submitted an Amended Demand for Arbitration dated February 3, 1995. Unlike the original Demand, this Amended Demand stated various counts for relief in a form similar to a complaint. The Amended Demand also expanded the number of counts to eight, including a Count VI seeking a declaration that the Arbitration Agreement was unenforceable.

The parties returned to the District Court to resolve their dispute over whether the new counts in the Amended Demand were arbitrable. In its motion on the issue, Schultz Motors' motion suggested that, even if some of the counts in the Amended Demand were identical to counts dismissed by the District Court, the arbitrator should be free to rule upon them.

In ruling on Schultz Motors' motion, the District Court disagreed with the argument that the arbitrator should be free to rule upon dismissed claims. "This Court may reconsider the prior order, . . . but the Arbitrator must adhere to the Court's rulings on legal issues." The District Court then ordered that 1) "the Arbitrator shall not consider Counts II,

III, and IV of the amended demand;" 2) "the Arbitrator shall consider Counts VII and VIII of the amended demand;" and 3) "the Arbitrator shall not consider any new claims which plaintiff may assert prior to this Court's determination that the claims are arbitrable." App. A-29.[3]

G. Schultz Motors Filed a Second Amended Complaint, which the District Court dismissed in part and which did not include a claim that the Arbitration Agreement was unenforceable

A few months after the District Court's ruling concerning its Amended Demand, Schultz Motors sought leave to file a Second Amended Complaint. This Second Amended Complaint expanded the number of counts to nine, but it contained no count or allegations concerning the enforceability of the Arbitration Agreement or any of its terms.

The District Court, entered an order on January 30, 1996, granting Schultz Motors leave to file the Second Amended Complaint. The order also specified which counts would be dismissed and which would be arbitrated: 1) "Counts I, II, III, IV and V of the Second Amended Complaint are hereby dismissed;" 2) "Counts VI, VII, VIII and IX of the Second Amended Complaint are referred to the previous arbitrator . . . ;" and 3) "The Court's previous ruling on the handling of this matter remains in effect." App. A-31.

As a result of this order, the District Court submitted to arbitration two counts alleging breach of contract and two counts alleging violation of the Missouri Motor Vehicle

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[3] Schultz Motors' Amended Demand included a "Count VI" that challenged the enforceability of the Arbitration Agreement. But the District Court did not refer this count to arbitration.

Franchise Practices Act. The order did not submit any enforceability issues to arbitration.

H. Kawasaki prevailed in the arbitration.

The arbitration proceeded in Los Angeles, California in March 2000. After a three-week hearing, the Arbitrator issued his liability ruling (the "First Award") and held, inter alia, that Kawasaki was not liable to Schultz Motors for any damages. The Arbitrator further held that "[Kawasaki] is the prevailing party in this proceeding and in accordance with ¶ 32 of the Agreements is entitled to recover from claimant all costs and expenses of the arbitration, including without limitation, attorney's fees." The Arbitrator then permitted Schultz Motors to conduct discovery regarding the attorney's fees and expenses and later conducted a hearing with respect to the amount of Kawasaki's costs and attorney's fees.

I. The Arbitrator issued a second opinion finding that the fee-shifting provision of the Arbitration Agreement was unenforceable.

At the hearing on Kawasaki's attorney's fees claim, Kawasaki established that its attorney's fees and litigation costs totaled $1,772,815.23. Schultz Motors renewed the enforceability arguments that the District Court had previously rejected, and which had not been submitted to arbitration, but this time directed them solely to the fee-shifting term of the Arbitration Agreement. Kawasaki contended that this issue had been resolved by the District Court.

The Arbitrator issued his Final Award of Arbitration (the "Second Award"), including his Statement of Reasons in Support of Ruling on Costs and Expenses, on January 31, 2001. In this Award, he ruled that the Arbitration Agreement should not have been enforced.

> The Arbitrator believes that ¶ 32 is unconscionable and should not have been

> enforced. However, the Court decided that the case should be referred to arbitration and declined to change the venue from Los Angeles to St. Louis. It's too late to alter that result at this time. However, the Court did not rule upon that part of ¶ 32 that requires the nonprevailing party to pay all of the costs and expenses of the prevailing party. The issue of the enforceability of that clause is properly before the Arbitrator at this time.

App. A-48. In reaching this conclusion, the Arbitrator made a number of findings that directly contradicted the District Court's two previous Orders. These contradictory rulings are shown on the following chart:

Court: "The court rejects Schultz Motors' argument that the franchise agreements are contracts of adhesion." (App. A-18).	***Arbitrator:*** "The arbitration clause of the franchise agreement is clearly a contract of adhesion . . . ." (App. A-44).
Court: "Nor does the Court agree that the arbitration clause lacks mutuality of obligation." (App. A-19).	***Arbitrator:*** "First, the Agreement lacks mutuality . . . ." (App. A-46).
Court: "Schultz Motors has failed to show that Kawasaki's arbitration clause is unconscionable or inherently unfair." (App. A-19).	***Arbitrator:*** "The Arbitrator also finds that the arbitration agreements were unconscionable at the time they were made . . . ." (App. A-44).

Court: "Schultz Motors next argues that the arbitration clause violates Missouri public policy as expressed in the Missouri Motor Vehicles Franchise Practices Act . . . . The Court disagrees." (App. A-19).	***Arbitrator:*** "Kawasaki's institutional policy of imposing its contractual terms on dealers with the threat of losing the dealership is just such an unlawful practice [under the Missouri Motor Vehicles Franchise Protection Act]." (App. A-44).
Court: "Counts VII and VIII of the amended demand are proper for arbitration . . . . The arbitrator should refuse to consider any additional claims until this Court has determined their arbitrability." (App. A-28). "[T]he Arbitrator must adhere to the Court's rulings on legal issues." (App. A-28).	***Arbitrator:*** "The Arbitrator . . . finds that . . . the Arbitrator is free to decide whether the costs and expenses provision of the arbitration clause is unconscionable . . . . It is the opinion of the Arbitrator that whether the costs and expenses provision of ¶ 32 is unconscionable or not is an open issue to be decided by the Arbitrator . . . (App. A-39).

J. The District Court enforced the Arbitrator's decision.

On February 16, 2001, the parties filed a joint motion with the District Court to reopen the case. Kawasaki filed its motion to confirm the Arbitrator's First Award with respect to liability and to vacate the Arbitrator's Second Award with respect to attorney's fees. Schultz Motors opposed Kawasaki's motion and moved in the alternative that the District Court vacate all of the Arbitrator's awards, including

the liability finding for Kawasaki, if the District Court concluded that the Arbitrator exceeded his powers in ruling on the enforceability of the fee-shifting provision.

On March 26, 2002, the district court issued a Memorandum and Order confirming both of the Arbitrator's awards in all respects. App. A-51 to A-64. The district court stated that "the arbitrator correctly interpreted this Court's order of March 30, 1994 as addressing only the issue of arbitrability, *i.e.*, whether the arbitration provision between the parties should be enforced to require their dispute to be arbitrated." App. A-60. The district court then declined to review the Arbitrator's decision, finding that the Arbitrator had the authority to "make mistakes" in ruling on legal questions such as enforceability.

> Given the arbitrator's power to interpret the Franchise Agreement, to find facts, to interpret and apply the law, and to make mistakes in so doing, the Court finds the arbitrator neither exceeded his powers nor awarded on a matter not submitted to him . . . ."

App. A-61. On this basis, the District Court confirmed the Arbitrator's Second Award and denied Kawasaki's motion to vacate the award with respect to attorney's fees. App. A-61 to A-62.

K. The Court of Appeals affirmed the District Court decision.

On July 1, 2003, the United States Court of Appeals for the Eighth Circuit affirmed the District Court's decision, holding that the Arbitrator acted within the scope of his authority by refusing to enforce the fee-shifting provision of the Arbitration Agreement. 334 F.3d 721; App. A-1 to A-12. Relying on *Larry's United Super, Inc. v. Werries,* 253 F.3d 1083 (8th Cir. 2001), the Eighth Circuit held that the issue of

the validity of the Arbitration Agreement's fee-shifting provision was an issue for the Arbitrator to decide with no review by the courts. 334 F.3d at 727 n.3; App. A-10. The Eighth Circuit denied Kawasaki's motion for rehearing *en banc* on August 13, 2003. App. A-64.

REASONS FOR GRANTING THE PETITION

1. Overview

Under the Federal Arbitration Act, courts decide gateway issues of arbitrability, unless the parties have clearly agreed to submit these issues to arbitration. *First Options v. Kaplan*, 514 U.S. 938, 943-44 (1995). There typically are two arbitrability issues: 1) whether the parties are bound by a given arbitration clause, and 2) whether the parties' dispute falls within the scope of the agreement to arbitrate. *See, e.g., Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002).

The courts of appeals disagree about the scope of the first issue, enforceability. In the First, Seventh, Eighth, and Eleventh Circuits, the courts divide the enforceability analysis. In those circuits, the court decides whether the partis are obligated to arbitrate. But, the arbitrator decides the enforceability of arbitration terms such as remedial limitations or fee-shifting provisions. Thus, these courts view the enforceability of arbitration terms as a separate issue from the enforceability of arbitration itself. (There is some inconsistency among these courts. For example, they disagree about whether courts should later substantively review the arbitrator's decision regarding the enforceability of arbitration terms.)

In the Third, Fourth, Fifth, Sixth, Ninth, and Tenth Circuits, the enforceability of the terms of an arbitration agreement is an issue for the courts. In these circuits, courts determine whether the parties' arbitration terms are enforceable and, if they are not, whether the unenforceable terms may be severed from the remainder of the arbitration agreement so arbitration can proceed. This majority position is consistent with the FAA, which directs the court to consider challenges to the "making" of an arbitration

agreement, and then to order "the parties to proceed with the arbitration in accordance with the terms thereof" (9 U.S.C. § 4) – a command that logically requires the courts to determine which "terms" are enforceable.

The majority position is also consistent with this Court's decisions on comparable issues. *See Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000) (considering whether an arbitration agreement's silence on the allocation of arbitration costs rendered it unenforceable); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30-33 (1991) (considering challenges to arbitration based upon limits on discovery, lack of written opinions, limits on equitable relief, and lack of class actions); *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989) (considering whether state court rule regarding staying arbitration, incorporated into the parties' arbitration agreement by a choice of law provision, was unenforceable because of a conflict with FAA); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.21 (1985) ("[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.").

In this case, Kawasaki happened to be seeking enforcement of its FAA rights in the Eighth Circuit. It was therefore subject to 1) overlapping and inconsistent rulings on the enforceability of arbitration terms by the District Court and the Arbitrator, 2) new claims by its opponent concerning the enforceability of arbitration terms after the District Court's section 4 proceeding and after the Arbitrator's award on the merits of the arbitration, and 3) no substantive judicial review of these matters. This would not have occurred in many other circuits. This Court should resolve the disagreements among the courts of appeals and

the conceptual confusion evident in the courts of appeals' opinions about what issues a court should decide, and when, in order to prevent such disparate applications of the FAA.

2. The courts of appeals disagree about whether the courts or arbitrators should decide the enforceability of arbitration terms.

As discussed below, the courts of appeals generally split four circuits to six on the question of who decides the enforceability of arbitration terms. *See, e.g., Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314, 316 (5th Cir. 2002) ("The circuit courts are split on whether the enforceability of an arbitration clause should be adjudicated before arbitration when a party contends that public policy prevents the clause's waiver of certain remedies."). There also are some inconsistencies and analytical disagreements within the minority group, further illustrating the need for a coherent resolution of this issue by this Court.

a. Six circuits allocate enforceability determinations to the courts (Third, Fourth, Fifth, Sixth, Ninth, and Tenth)

Sitting *en banc*, the Sixth Circuit recently addressed the enforceability of the terms of an arbitration agreement. *See Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003). *Morrison* involved two employees whose employment agreements contained arbitration provisions that provided, among other things, for splitting arbitration costs among the parties, and one employee's agreement imposed limits on the remedies he could obtain through arbitration. The employees contended that these provisions had the effect of denying them a forum for the vindication of their statutory rights.

The *Morrison* Court analyzed how and when such challenges should be made, explicitly rejecting post-

arbitration judicial review and implicitly rejecting arbitration as the correct venue. 317 F.3d at 657-65. The court then considered the merits of the challenges to the arbitration provisions. It found that some of the provisions in each arbitration agreement were unenforceable, *id.* at 665-74, 675-77, but also determined that these provisions were severable from the remainder of the arbitration agreements, thus making arbitration appropriate. *Id.* at 674-75, 678.

Most of the courts of appeals follow a similar pattern of analysis in evaluating challenges to the enforceability of arbitration terms. *See Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003)[4]; *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Hadnot v. Bay, Ltd.*, 344 F.3d 474 (5th Cir. 2003); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); *Shankle v. B-G Maintenance Management*, 163 F.3d 1230 (10th Cir. 1999).

On numerous occasions, these circuits have explicitly concluded that courts, not arbitrators, should decide the enforceability of arbitration terms. *See Spinetti v. Service Corp. Int'l*, 324 F.3d 212, 216 n.1 (3d Cir. 2003); *Investment Partners*, 298 F.3d at 316; *Burden v. Check Into Cash*, 267 F.3d 483, 492-93 (6th Cir. 2001); *Shankle*, 163 F.3d at 1235; *accord Anders v. Hometown Mortgage Services, Inc.*, 346

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[4] In 1997, the Third Circuit issued an opinion holding that the enforceability of arbitration provisions addressing attorney's fees, statute of limitations, discovery, and punitive damages was for the arbitrator. *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222, 230-32 (3d Cir. 1997). But the court also seemed to substantively reject the argument that public policy precluded enforcement of the provisions. Regardless of the interpretation of this opinion, recent opinions in *Alexander, Spinetti v. Service Corp. International*, 324 F.3d 212, 216 n.1 (3d Cir. 2003), and *Harris v. Green Tree Financial Corp.*, 183 F.3d 173, 183-84 (3d Cir. 1999), clarify that, in the Third Circuit, courts determine the enforceability of arbitration terms.

F.3d 1024, 1028 (11th Cir. 2003) (although the Eleventh Circuit submits such issues to arbitrators, and did so in this case, the court stated that such challenges fall "within the category of 'gateway matters' which the Supreme Court has instructed us that courts and not arbitrators should decide.").

b. Four circuits allocate enforceability determinations to the arbitrator (First, Seventh, Eighth, Eleventh)

The Eleventh Circuit addressed the enforceability of an arbitration attorney's fee-shifting provision in *Thompson v. Irwin Home Equity Corp.*, 300 F.3d 88 (11th Cir. 2002), a case relied upon by the Eighth Circuit below. The *Thompson* Court held that the courts should only decide enforceability issues that are essential to determining whether an arbitration should occur, not the terms governing the arbitration. "'A court compelling arbitration should decide only such issues as are essential to defining the nature of the forum in which a dispute will be decided . . . .'" *Id.* at 91 (quoting *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083, 1085 (8th Cir. 2001)). Therefore, the enforceability issue was sent to the arbitrator to decide.

The last paragraph of the *Thompson* opinion, however, suggested that the issue of enforceability could be revisited by the courts after the arbitration.

> Arbitration is the correct initial forum for the Thompsons to air their objection to the attorney's fees provision in the arbitration agreement. If an arbitrator does award attorney's fees against the Thompsons, the district court would then be in a position to hear their argument that the challenged provision on attorney's fees is unenforceable because it deprives them of a statutory right.

300 F.3d at 92. This holding indicates that both arbitrators and the courts should determine the enforceability of some arbitration terms, although the applicable judicial standard of review and the source of authority for that review is unclear.

Like the Eleventh Circuit, the Eighth Circuit allocates to arbitrators the role of evaluating the enforceability of the terms of arbitration agreements. But it approaches judicial review of arbitrators' decisions differently. In the present case, the Court of Appeals relied upon its earlier decision in *Werries*, in which it concluded that an arbitrator should consider the enforceability of an arbitration provision that precluded punitive damages. The court concluded that the fee-shifting clause in the present case was like the punitive damage provision in *Werries*. "[The fee-shifting provision] is of the same ilk as the claim we considered in *Werries*. Therefore, the claim was properly presented to the arbitrator and not the District Court." 334 F.3d at 727 (footnote omitted), App. A-10.

But, unlike the Eleventh Circuit, the Eighth Circuit does not review an arbitrator's enforceability rulings. In the footnote omitted from the foregoing quote, the Eighth Circuit made this clear:

> We have no occasion to review the merits of the arbitrator's ruling on the validity of this provision. *See United Paperworkers Int'l Union v. Misco, Inc*, 484 U.S. 29, 38, 108 S.Ct. 364, 98 L.Ed.2d 286 (1987) (observing that courts "do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts . . . . As long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious

> error does not suffice to overturn his decision") . . . .

Id. at n.3, App. A-10. This is consistent with the District Court's conclusion that, in ruling on enforceability, an arbitrator is free to "interpret and apply the law, and to make mistakes in so doing . . . ." App. A-61.

The Eleventh Circuit takes a different approach that combines judicial and arbitral roles in deciding enforceability. In *Anders*, the court considered a party's contention that his arbitration agreement was unenforceable because it restricted the remedies available to him. The *Anders* Court held that this contention should be resolved by an arbitrator, but it was not writing on a clean slate regarding the issue. The Eleventh Circuit had previously held that a limitation on remedies rendered an arbitration agreement unenforceable, deciding the issue rather than leaving it to an arbitrator. *See Paladino v. Avnet Computer Tech., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998).

Reconciling its holding with *Paladino*, the *Anders* Court explained that if the unenforceable arbitration terms are not severable from the arbitration agreement, then the arbitration agreement as a whole is unenforceable and the enforceability issue must be resolved by the court. That was the outcome in *Paladino*. But if the arbitration terms at issue can be severed from the arbitration agreement, as was the case in *Anders*, then the enforceability issue is for the arbitrator. *Anders*, 346 F.3d 1024, 1029-30. Under *Anders*, therefore, the court first considers severability and then considers enforceability only if the provision is not severable.

The Seventh Circuit also splits enforceability determinations between the courts and arbitrators, but using a different criterion than the Eleventh Circuit. In the Seventh Circuit, the courts decide the enforceability of arbitration terms if the terms allegedly violate federal statutory rights. But the arbitrator decides enforceability if state common law

claims are at issue. *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003). The Seventh Circuit explained that, in its opinion, this was the correct approach in light of this Court's decision in *Gilmer*.

3. This Court should clarify the extent to which a district court's ruling on arbitrability under Section 4 of the FAA constrains the arbitrator's powers within the meaning of Section 10(a)(4) or the scope of the matters submitted to the arbitrator within the meaning of Section 11(b).

Under the FAA, a district court's section 4 ruling compels the parties to arbitration under the terms of their arbitration agreement. This logically defines the arbitration terms that are and are not enforceable, thereby establishing the powers of and the matters submitted to the arbitrator. Confusion about this analysis, however, has led to disagreements among the courts of appeals concerning the enforceability issues discussed above and led to the failure of the lower courts in this case to correct the Arbitrator's enforceability ruling, a ruling that effectively overruled the District Court's section 4 arbitrability order.

a. The FAA establishes a basic framework for pre- and post-arbitration actions in the district court.

Sections 4, 10, and 11 of the FAA establish the basic framework for the courts' role in enforcing arbitration agreements. Section 4 instructs the district court to determine whether an enforceable agreement to arbitrate exists. If an enforceable agreement exists, the district court must order the parties to proceed to arbitration in accordance with the terms of that agreement. 9 U.S.C. § 4.

Once the arbitrator has ruled on the parties' dispute, either party may then challenge the arbitrator's decision before the district court. Section 10 provides for arbitration

awards to be vacated "where the arbitrators exceeded their powers," or under other specified circumstances. 9 U.S.C. § 10(a). Similarly, section 11 provides for arbitration awards to be modified or corrected where the arbitrator "awarded upon a matter not submitted to them" or made other specified errors. 9 U.S.C. § 11.

By these sections, then, the FAA establishes a clearly-defined system for pre- and post-arbitration judicial review. It provides for the courts to establish the enforceable terms of an arbitration agreement pursuant to section 4 and to review an arbitrator's award under sections 10 and 11. Nothing in the FAA indicates that arbitrators have the authority to overrule the conclusions of the courts.

b. The various circuit courts have employed schemes for pre- and post-arbitration judicial review that fail to follow the FAA framework.

The Eleventh Circuit holds that courts should conduct post-arbitration review of an arbitration award to determine which terms of the arbitration agreement under which the arbitration was conducted are (or were) enforceable. *Thompson*, 300 F.3d at 92. In the Eighth Circuit, however, no post-arbitration review of an arbitrator's rulings on enforceability is permitted. *Bob Schultz Motors*, 334 F.3d at 727 n.3, App. A-10.

Neither analysis is consistent with the FAA. Contrary to the conclusions of both circuits, enforceability determinations are made when a court rules on arbitrability and sends a dispute to arbitration "in accordance with the terms" of the parties' agreement. 9 U.S.C. § 4. Contrary to the conclusion of the Eleventh Circuit, sections 10 and 11 of the FAA do not provide for post-arbitration enforceability determinations.

Despite the lack of authority for post-arbitration evaluation of enforceability issues, the FAA does permit post-arbitration review to assure that sufficiently important rights and interests are preserved in the arbitration process. "[T]he question of public policy is ultimately one for resolution by the courts. . . . If the contract as interpreted by [the arbitrator] violates some explicit public policy, we are obliged to refrain from enforcing it." *W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757, 766 (1983); *see also Mitsubishi*, 473 U.S. at 638 ("Having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed.").

Post-arbitration review also ensures that the arbitrator has complied with applicable court orders – another important public policy. "It is beyond question that obedience to judicial orders is an important public policy." *W.R. Grace*, 461 U.S. at 766.

Moreover, the FAA expressly provides that an arbitrator is constrained by his "power" (section 10(a)(4)) and the "matter . . . submitted" to him (section 11(b)). Although these constraints are usually found in the parties' arbitration agreement, the validity and enforceability of that agreement is governed by court orders. 9 U.S.C. §§2, 4. *A fortiori*, the arbitrator's power and the matter submitted to him or her are governed by court orders. *See Brown v. Witco Corp.*, 340 F.3d 209, 221 (5th Cir. 2003) (arbitrator's award that exceeded scope of court's order vacated).

In this case, the District Court and the Court of Appeals sanctioned the Arbitrator's enforceability ruling, which was based upon a fundamental disagreement with a prior court order. These actions by the courts and the Arbitrator were inconsistent with the FAA. If the District Court had erred in its enforceability analysis, that was an

issue to be resolved by the courts, not the Arbitrator. When the Arbitrator purported to rule upon the issue, he exceeded his powers and ruled upon a matter not submitted to him. By refusing to vacate or modify the award, the lower courts acted inconsistently with the FAA and with cases such as *W.R. Grace* and *Brown* that recognize the primacy of court orders.

Clarification of the role of the courts and arbitrators under the FAA also would resolve an analytical disagreement between the Eleventh and Seventh Circuits. Both of these courts permit arbitrators to determine the enforceability of some arbitration terms, but they disagree about which enforceability issues go to the arbitrator. In the Seventh Circuit, federal courts determine the enforceability of arbitration terms that allegedly violate federal rights, but not those that violate state rights. *Hawkins*, 338 F.3d at 807. In the Eleventh Circuit, courts determine the enforceability of arbitration terms that are not severable from the arbitration agreement, but arbitrators decide the enforceability of severable arbitration terms. *Anders*, 346 F.3d 1024, 1029-30. These distinctions do not exist in the FAA, and this Court's clarification of the importance of following the statutory scheme will resolve this and other disagreements among the courts of appeals.

CONCLUSION

The opinions of the courts of appeals are inconsistent among themselves, with the FAA, and with rulings of this Court. The FAA embodies a federal policy encouraging arbitration according to the terms of arbitration agreements. Consistency among the courts of appeals concerning the application of this statute and the respective roles of the courts and arbitrators is necessary to ensure that federal law does in fact encourage arbitration. Action by this Court is necessary to achieve this consistency. Kawasaki therefore respectfully requests that this Court grant this petition for a writ of certiorari.

Respectfully submitted,

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